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SUBJECT: TURKEY'S ELECTRICITY SECTOR: ANGST AND
OPPORTUNITY

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¶1. (SBU) SUMMARY: Turkey's long anticipated electricity shortage is at hand. The government's slow progress on liberalization, market pricing, rule-making, and privatization have led to failure to deliver new investment, so the government is already confronted with managing electricity supply gaps. The private sector is disappointed by the delay in the electricity distribution privatization (reflets), but interested in the potential nuclear program. One Turkish company, Park Holding -- rather unrealistically, without specification on government purchase guarantees -- has already bid for a nuclear license. End Summary.

Electricity Shortfall Looms

¶2. (SBU) At A March 8-9 energy conference in Istanbul, company executives were excited about opportunities in Turkey's energy sector, tempered by angst and frustration about slow progress on liberalization and attracting investment. In his opening speech, Energy Market Regulatory Agency President Yusuf Gunay, called for more progress on attracting investment and privatization of electricity infrastructure. Noting the risk of a California-style crisis and heightened risk of black-outs, he called for liberalization of prices and establishment of a real energy market. Gunay admitted that establishment of the "Balance and Reconciliation" system for marginal prices was a good start. He cautioned that the public should not expect price decreases to the consumer.

¶3. (SBU) In his comments, Energy Minister Hilmi Guler stressed the indispensability of Turkey's unique

geography in serving as an energy corridor and terminal. He and others spoke out in support of the new petroleum law (partially vetoed by President Sezer and under study at the parliament) to attract upstream foreign investment and supported diversifying Turkey's energy mix by increasing use of coal, hydroelectric, and other renewable energy, as well as launching the new nuclear program. (Note: the President recently partially vetoed the new Energy Efficiency law.) Pointing to the lack of progress, Dogan Holding Director Yahya Uzdiyen said, "I have attended this conference for six years, but in recent years, there is no progress; we are talking about the same things."

Frustration from the Regulator

¶4. (SBU) In a separate meeting, Energy Market Regulatory Agency (EMRA) President Yusuf Gunay defended his record at the five-year old regulator, but lamented lack of political will elsewhere in the government to fulfill the goals of a liberal market articulated in the energy market law and electricity strategy paper. He lauded progress on areas under EMRA's control: licensing hydroelectric and wind licenses, as well as awarding delivery of natural gas distribution in over forty municipalities. Gunay regretted that privatization of electricity distribution (postponed) and generation (delayed) as well as realization of all aspects of a liberal electricity market were not under EMRA's control. He criticized the government for still being too present with a heavy hand in the sector, not letting go its historical function as contractor, buyer, and seller in the market. Gunay also criticized

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the World Bank in acquiescing in allowing delays in privatization and liberalization. Gunay pointed out that these delays were hurting the investment environment and Turkey's anticipated electricity shortage had already come to pass. He referred to a significant black-out last summer and anticipated more in the coming summer (reftels). Gunay asserted that at times this winter, Turkey has not been able to satisfy demand. Gunay will step down as EMRA President in November.

¶5. (SBU) Meanwhile, there are already signs of Gunay's sobering prediction coming to pass. Major electricity supplier ENKA's Ankara rep confirmed to us that the Energy Ministry recently had to orchestrate rolling cut-offs of some 1,000 MW to some industrial customers in order to make supply meet demand. The Enka rep complained that the electricity distribution "postponement" will be a big negative for attracting investment in the electricity sector, including generation and the proposed nuclear plants.

Electricity Prices an Issue for IMF

¶6. (SBU) Another obstacle to sufficient investor confidence in the electricity sector is the GOT's long unwillingness to allow market pricing. In the absence of price increases -- and private sector confidence that price-setting will be divorced from political considerations -- the post-election privatization of the electricity distribution companies will be far less attractive to bidders, nor will the sector attract the needed private investment to expand generation capacity. The Government's putting off of needed electricity price increases has emerged as the single most contentious issue in the IMF stand-by program. A recent IMF mission reached broad agreement in every

other area but left town March 21 without a deal on the finances of state-owned energy companies. Absent electricity price increases, the IMF expects these companies to show losses that will make it harder for the Government to meet its fiscal target. In the election year context, the Government is digging in its heels against price increases, preferring to look for spending cuts at the state companies or, if necessary, elsewhere in the public sector. At the same time, the IMF is pushing for a longer-term structural fix to the politicization of electricity pricing policy.

Nuclear Dreams

¶7. (SBU) The GOT's decision to seek to add nuclear to its energy mix is a longer term ambition, but the GOT hopes to attract investors soon. Turkish Press reported that Ciner Group's Park Holding applied for a nuclear power generation license with the Energy Market Regulatory Authority and the Turkish Atomic Energy Authority on March 15. This is the first official application made by a private company, although the domestic private sector participated in a number of meetings with the GOT on possible models that could be used in establishing nuclear power plants. Park Energy's application was remarkable in that it was not predicated on any state guarantees in building the plant or in purchasing the electricity. Moreover, the GOT has not yet established the underlying legislation and regulation for the proposed nuclear sector. Zorlu is another prominent Turkish energy company which has expressed serious interest in Turkey's nuclear quest. A number of international companies are reported to be watching closely.

Comment

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¶8. (SBU) While we promote Turkey's contribution to a "southern gas corridor", it is important to remember that Turkey faces looming domestic problems with respect to electricity supply, reliance on expensive energy imports, BOTAS' financial woes, and potential gaps in natural gas supply. Turkey's political calendar is heating up with Presidential elections this spring and parliamentary elections this autumn, so this will make it doubly difficult to make hard decisions on sensitive issues like energy pricing and foreign investment. Electricity shortage in Turkey may also make it more difficult to implement the proposed increase in electricity exports from the national grid to northern Iraq.

McEldowney